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Supreme Court of the United States

OCTOBER TERM, 1969

No. [REDACTED] 42

HOWARD ROSS and BERNARD ROSS, as Trustees for
LENA ROSENBAUM,

Petitioners,

—v.—

ROBERT A. BERNHARD, *et al.*,

Respondents,

and

PAUL L. DAVIES, *et al.*,

Defendants.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONERS

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No. 992

HOWARD ROSS and BERNARD ROSS, as Trustees for
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and

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REPLY BRIEF FOR PETITIONERS

I.

A corporation's legal cause of action is triable to a jury whether it is asserted by the corporation itself or by a stockholder derivatively on its behalf.

The nub of respondents' argument, and of the decision below, is that a corporation's legal claim, triable by jury, is transmuted into an equitable cause when a stockholder asserts it derivatively on behalf of the corporation. The proposition, we submit, is contrary to reason and controlling precedent.

1. *Fleitmann v. Welsbach Street Lighting Co.*, 240 U.S. 27 (1916), was a stockholder's derivative action for treble damages under the antitrust laws. The Court noted that "the claim set up is that of the corporation alone;" if asserted by the corporation, it would be at law and triable to a jury (p. 28). This raised the question of whether "the defendants' right to a jury trial should be taken away" just because a stockholder, unable to induce action by his corporation, brought the suit derivatively on its behalf.

The Court, by Mr. Justice Holmes, answered the question in the negative. The damage claim was at law. It did not lose its legal nature through assertion in a derivative suit. The derivative suit did *not* transmute the legal into an equitable claim. The right to jury trial remained intact and inviolate.

Under then existing procedure, this conclusion was fatal to the plaintiff. In 1916 law and equity were separate. Fleitmann had brought his suit on the equity side of the district court. Equity alone gave him standing to sue on behalf of the corporation. But an equity court could not conduct a jury trial. The complaint thus had to be dismissed.

So far as *Fleitmann* dealt with the jury issue, it controls the present case. Here, as in *Fleitmann*, a stockholder asserts his corporation's legal claims derivatively on its behalf. Here, as in *Fleitmann*, the claims, no matter how asserted, remain what they are, claims at law belonging to the corporation. Here, as in *Fleitmann*, the derivative action does not impair the parties' right to jury trial of the legal claims.

What has changed since the days of *Fleitmann* are the consequences flowing from this state of affairs. Law

and equity have been merged by the adoption of the Federal Rules in 1938. The same court can now administer legal and equitable relief in the same case. The equitable issues are tried by the court, the legal issues by a jury. Under its equity powers, the court determines, without a jury, whether the complaining stockholder has the requisite standing to sue derivatively on behalf of the corporation. In the same suit, however, the court can try the corporation's legal cause of action to a jury. No more room, therefore, is left today for a dismissal such as was necessary in the pre-merger era of *Fleitmann*. The right to jury trial, recognized by this Court in *Fleitmann*, can now be given full scope and effect.

2. The decision below misconceived the impact of *Fleitmann*. The majority of the court read the case as holding that "there could be no right to a jury trial in the equitable derivative action" (A67). The opinion overlooked that *Fleitmann* sustained the right to jury trial; it merely held that an equity court could not administer it. This obstacle has disappeared under the Federal Rules.

The majority below also sought to distinguish *Fleitmann* as relating "only to the statutory right to jury trial created by the Sherman Act" (A68; emphasis by the court). The attempted distinction between the constitutional and the statutory jury right rests on several erroneous premises.

In the first place, the antitrust laws create no right to jury trial. In fact, neither the Sherman Act nor the Clayton Act so much as mentions trial by jury. The two Acts do create the right to treble damages; but it is the Seventh Amendment to the Constitution which provides for the

trial of the claim by jury. 5 *Moore's Fed. Pr.* ¶ 38.11[5] at 113-14 (2d Ed. 1968).*

Secondly, even if the right to jury trial of treble damage claims had a statutory basis, it is difficult to see why the statutory right should enjoy greater sanctity than the constitutional right to a jury. If a statutory jury right survives in a derivative suit, the jury right created by the Constitution cannot be more fragile.

Finally, if the Sherman and Clayton Acts were thought to imply a statutory right to jury trial, the same must be said of the Investment Company Act, under which the present action is brought (A20). Section 44 of that Act, 15 USC § 80a-43, expressly provides for "actions at law brought to enforce any liability or duty created by" the Act. If the statutory basis of the jury right be relevant at all, the Investment Company Act provides that basis no less than the Sherman and Clayton Acts.**

We submit, therefore, that *Fleitmann* cannot be distinguished from the present case. It clearly establishes petitioners' right to a jury trial of the underlying corporate claim.

* See *Leimer v. Woods*, 126 F. 2d 829, 32 C. Cir. (1952); The right to jury trial of double damages claims under the Emergency Price Control Act falls within the jury trial guarantee of the Seventh Amendment.

** The majority below refused to consider this argument in the belief that it had not been raised in the district court and that the record was insufficient to enable the court to address the issue (A68, n. 1). In fact, however, petitioners *had* raised the same argument in their district court brief of August 25, 1947 (p. 7). Moreover, since petitioners had prevailed in the district court, they were free to advance any arguments, even new ones, to sustain that court's decision; *Lettelle v. Scofield*, 308 U.S. 445, 421, at n. 8 (1940). Finally, it is obscure in what respects the record Iglow is supposed to have been insufficient; the effect of § 44 of the Investment Company Act is a pure question of law.

3. Respondents maintain (Br. 10-11) that the two elements of a derivative suit—the corporation's cause of action and the stockholder's right to assert it—were never deemed to be separate for jury trial purposes. Prior to 1938, they say, legal and equitable claims could not be joined in one equity action; *Scott v. Neely*, 140 U.S. 106 (1891); *Cates v. Allen*, 149 U.S. 451 (1893). Yet the federal courts did accept jurisdiction of derivative suits. It follows, according to respondents, that this Court must have rejected the notion that derivative suits can involve separate legal and equitable rights.

Respondents' syllogism is faulty. In the two decisions of this Court which they cite—*Dodge v. Woolsey*, 59 U.S. (18 How.) 331 (1855), and *Hawes v. Oakland*, 104 U.S. 450 (1882)—the underlying claims, seeking an injunction, were equitable, so that the problem of combining legal with equitable claims in a single derivative suit did not arise. The one case in which the problem did arise was *Fleitmann*; and there the Court did bar the assertion of a legal claim as incompatible with the equitable character of a derivative suit.

In this context, Mr. Justice Holmes addressed himself to the very point which respondents raise here: If a corporation's legal claim could not be asserted in an equity suit such as a stockholder's action, how could the federal courts ever accept jurisdiction of derivative suits? The answer was simple. In other derivative cases, the underlying corporate claim had been equitable; or, if it was legal, the defendants had not insisted on their jury rights. As stated by Justice Holmes (*Fleitmann*, 240 U.S. at 28-29):

"No doubt there are cases in which the [equitable] nature of the right asserted for the company,

or the failure of the defendants concerned to insist upon their [jury] rights, or a different state system, has led to the whole matter being disposed of in equity; * * * [Parenthetical interpolations added]

In short, for purposes of determining the right to jury trial, it was well settled even before 1938 that the corporation's underlying claim presented issues wholly separate from those pertaining to the stockholder's standing. Indeed, the recognition of the dual nature of the derivative suit has its root in *Hiques v. Oakland*, 104 U.S. 450, 452-53 (1882), where the Court viewed the stockholder's derivative action as combining "two causes of action":

"one against his own company, of which he is a corporator, for refusing to do what he has requested them to do; and the other against the party which contests the matter in controversy with that corporation."

Accord; *Ballantine, Corporations*, § 145 at 343-44 (Rev. Ed. 1946); *13 Fletcher, Corporations*, § 5946 at 429 (M. Wolf Ed. 1961) (both with numerous citations); *Halpern v. Pennsylvania R. Co.*, 189 F. Supp. 494, 498 (E.D.N.Y. 1960); *Riviera-Congress Associates v. Yassky*, 18 N.Y. 2d 540, 547, 277 N.Y.S. 2d 386, 392, 223 N.E. 2d 876 (1966).

The adoption of the Federal Rules in 1938 has not changed the dual nature of the derivative suit; but it has eliminated the procedural impediments to jury trial of the legal issues involved in such an action. The leading case on the subject, *Fanchon & Marvo v. Paramount Pictures*, 202 F. 2d 731, 735 (2 Cir. 1953), so held; and it has been consistently followed by later decisions: *Rogers v. American Can Co.*, 304 F. 2d

297, 307-8 (3 Cir. 1962); *Ramsburg v. American Investment Co.*, 231 F. 2d 333, 339 (7 Cir. 1956); *DePinto v. Provident Security Life Ins. Co.*, 323 F. 2d 826, 836-37 (9 Cir. 1963), cert. den. 376 U.S. 950; *Schechtman v. Wolfson*, 244 F. 2d 537, 539 (2 Cir. 1957); *Kogan v. Schenley Industries*, 29 F.R.D. 4 (D. Del. 1956); *Gomberg v. Midvale Co.*, 157 F. Supp. 132, 140-41 (E.D. Pa. 1955).

We submit that petitioners' right to trial by jury of the corporation's cause of action is not to be denied just because the claim is asserted in a stockholders' derivative action.

II.

The underlying causes of action of the corporation are legal claims triable by jury.

The District Court held that this action, viewed as one brought by the Corporation, is "a suit at common law" within the meaning of the Seventh Amendment (A46-48). The majority of the Court of Appeals did not reach the question (A64), but the dissenting Judge agreed with the District Court that the action is at law because it is "for a money judgment for unlawful conversion, breach of fiduciary duty, fraud and gross negligence" (A72-73).

Respondents contend that an action against corporate directors for breach of fiduciary duty cannot be brought at law and that, in any event, the complexity of this action would force it into equity.

1. Contrary to respondents' assertion, *damages* claims for breaches of duty by corporate directors are traditionally at law, unless the legal remedy is inadequate. In

Hazard v. Wight, 201 N.Y. 399, 94 N.E. 855 (1911), the defendant president and director caused his corporation to pay him part of its capital. The court held (201 N.Y. at 402):

"The defendant thereby violated the statute [citation] and the principles of the common law and became liable in an action at law to the corporation for wasting its assets."

Accord, e.g., *DePinto v. Provident Security Life Ins. Co.*, 323 F. 2d 826, §36-37 (9 Cir. 1963), cert. den. 376 U.S. 950 (1964); *Kelly v. Dolan*, 233 Fed. 635, 637 (3 Cir. 1916); *O'Brien v. Fitzgerald*, 143 N.Y. 377, 380-81, 38 N.E. 371 (1894); *Potter v. Walker*, 276 N.Y. 15, 26, 41 N.E. 2d 335, 337 (1937); *Kocon v. Cordeiro*, 98 R.I. 772; 200 A. 2d 708, 710-11 (1964); *Minister L. & S. Co. v Laufersweler*, 37 Ohio App. 375, 36 N.E. 2d 895 (1940).

The present action alleges a claim for damages. The legal remedy is adequate. In light of the discovery procedures of the Federal Rules, neither an equitable discovery nor an equitable accounting is necessary. The prayer of the complaint for an accounting may be ignored. *Dairy Queen v. Wood*, 369 U.S. 469, 477-78 and n. 19 (1962); *Beacon Theatres v. Westover*, 359 U.S. 500, 509-10 (1959).

2. Respondents suggest (Br. 16) that an action at law lies only for negligent (as distinguished from willful) fiduciary breaches. The present complaint does allege negligence (A26). The scope of the action at law is not, however, limited to negligence. The notion that a jury may find a fiduciary to be negligent but must bow out if it finds a higher degree of fault defies both reason and authority. In *Schine v. Schine*, 367 F. 2d 685 (2 Cir. 1966)—a case invoked by

respondents—the second count of the complaint sought damages for the fraud of the defendant fiduciaries; the court held that the claim was at law and triable by jury.* Willful conversion, such as is here alleged (A26), is likewise a familiar area of jury competence, *United States v. Bitter Root Dev. Co.*, 200 U.S. 451, 472 (1906). A fiduciary chargeable with conversion, see *Brown v. Bullock*, 294 F. 2d 415, 420 (2 Cir. 1961), cannot sidestep a jury just because he is a fiduciary. This is equally true of a claim for waste of corporate assets; *Hazard v. Wight, supra*, 201 N.Y. 399, 402, 94 N.E. 855.

3. Respondents' liability for the profits they derived from their breaches of duty is likewise cognizable at law. Although claims of that character have often been entertained in equity, *Schine v. Schine, supra*; *In re The Van Sweringen Co.*, 119 F. 2d 231, 235 (6 Cir. 1941), they need not be. A fiduciary who profits from his breach of duty is unjustly enriched. He is liable in assumpsit for money had and received. *B. F. Goodrich Co. v. Naples*, 121 F. Supp. 345, 347-48 (S.D. Cal. 1954); *Gottfried v. Gottfried*, 269 App. Div. 413, 56 N.Y.S. 2d 50, 56 (1945); *Wagner v. Armsby*, 264 App. Div. 379, 35 N.Y.S. 2d 488, 489 (1942). Although this quasi-contractual form of action employs equitable principles, if is, nevertheless, an action at law, one of the common counts, and hence is triable by jury. See *Myers v. Hurley Motor Co.*, 273 U.S. 18, 24 (1927); *Okeechobee County v. Nuveen*, 145 F. 2d 684, 687 and n. 5 (5 Cir. 1944); *Restatement, Restitution*, pp. 5-9 (1937). In fact, the accounting claim in *Dairy Queen, supra*, which this Court held

* The fourth count, seeking an accounting of profits, was held to be equitable. The nature of the second and fourth counts appears from the record of the *Schine* case.

to be triable to a jury, sought "an accounting of profits"; see the lower court's decision in that case, *McCullough v. Dairy Queen*, 194 F. Supp. 686, 687 (E.D. Pa. 1961).*

4. Respondents argue that the complexity of the claims necessitates their trial in equity. Complexity as such is not, however, an obstacle to jury trial. *Curriden v. Middleman*, 232 U.S. 633, 636 (1914):

" * * * mere complication of facts alone and difficulty of proof are not a basis of equity jurisdiction."

Accord: *United States v. Bitter Root Dev. Co.*, 200 U.S. 451, 472 (1906).

An exception to this broad rule used to apply where "the accounts between the parties" were of such a complicated nature that only a court of equity could satisfactorily unravel them. *Kirby v. Lake Shore & M.S.R. Co.*, 120 U.S. 130, 134 (1887); *Dairy Queen v. Wood*, 369 U.S. 469, 478 (1962): Respondents themselves do not contend that this action is based on "the accounts between the parties". An account could arise, as it did in *Kirby*, from a long-drawn contractual relationship between the parties. By contrast, a mere multiplicity of torts, such as is here alleged, was never thought to create an "account" and never afforded the wrongdoer an escape from the jury.

In any case, equity's jurisdiction of complicated accounts has, under modern practice, shrunk to the point of disappearance: *Dairy Queen v. Wood*, *supra*, 369 U.S. at 478:

"In view of the powers given to District Courts by Federal Rule of Civil Procedure 53(b) to appoint masters to assist the jury in those exceptional cases where the legal issues are too complicated for the

* See also p. 6 of the Brief for Respondents in this Court in *Dairy Queen*.

jury adequately to handle alone, the burden of such a showing [that only equity can unravel the complicated accounts] is considerably increased and it will indeed be a rare case in which it can be met." (Parenthetical interpolation added; footnotes omitted)

The present action is not that "rare case". The experienced trial judge below held that "[t]he issues are not so complicated as to make it impracticable for a jury to ascertain the amount, if any, to which plaintiffs may be entitled" (A47). Judge Smith in the Court of Appeals agreed that "[t]he issues are not so complex as to be beyond the competence of a trial jury" (A73).

Respondents' apprehension that "many thousands of separate portfolio transactions" must be scrutinized would not take the case into equity and is, in any event, unfounded. Petitioners do not propose to present their evidence in such piecemeal fashion. They propose to prove from respondents' own admissions, that respondents engaged deliberately and systematically in the improper practices here alleged. If persistent wrongdoing on respondents' part emerges, the Corporation's damages may well be measured by the readily ascertainable amount of respondents' compensation, *Wilshire Oil Co. v. Riffe*, 406 F. 2d 1061 (10 Cir. 1969); and the same will be true if the illegal composition of the Corporation's board of directors (Compl. par. 19; A25-26) invalidates the Corporation's relationship to the respondent broker, see *Phillips v. S.E.C.*, 388 F. 2d 964, 966 (2 Cir. 1968).

None of these issues presents inordinate difficulties for a jury. If unexpected complications were to develop, the jury might receive the help of a master, Rule 53(b) FRCP; *Dairy Queen, supra*. These and other details may safely be

left to the trial court and can be dealt with at the pre-trial conference, Rule 16 FRCP. The time, we submit, has passed when technicalities of that nature could stand in the way of the constitutional right to jury trial.

CONCLUSION

The judgment of the Court of Appeals for the Second Circuit should be reversed.

Dated: October 14, 1969.

Respectfully submitted,

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